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Supreme Court of the United States

MAY TERM, 1953

No. [redacted]70

COLONIAL FABRICS, INC.,

Petitioner,

—v.—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

MARK M. HORBLIT
Attorney for Petitioner

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioner, Colonial Fabrics, Inc., respectfully prays that a writ of certiorari issue to the United States Court of Appeals for the Second Circuit to review a decision and judgment of that court entered February 16, 1953 affirming a determination of The Tax Court of the United States entered September 13, 1951.

Opinions Below

The findings and opinion of The Tax Court are set forth in the record (pp. 97a to 111a). The opinion of the Court of Appeals is reported in 202 Fed. 2nd 105.

Jurisdictional Statement

The jurisdiction of this Court is invoked under Sections 1254 and 2101 of the United States Code, Judiciary and Judicial Procedure.

This application is made within ninety days after the entry of the decision of the Court of Appeals.

Summary Statement of the Matter Involved

The matter involved is the validity of deficiencies assessed by the Commissioner for the period April 9 to December 31, 1943 as a result of his reducing the cost to the petitioner of certain merchandise purchased by it on June 28, 1943 for 200 shares of its common capital stock, from $100,000.00 to $30,000.00.

The petitioner, a New York corporation, was incorporated on April 9, 1943 and thereafter engaged in the business of buying, converting and selling drapery and upholstery fabrics. Its authorized capital stock was 1000 shares without par value, of which 500 were preferred shares and 500 were common shares. At the first meeting of the petitioner's Board of Directors held on April 9, 1943, a resolution was adopted that the shares of preferred stock be issued, for cash, at $50.00 per share; and that the shares of common stock be issued, for cash or property, at $500.00 per share. Prior to June 28, 1943, the petitioner had, pursuant to said resolution, received payments for, and had issued, 180 of its preferred shares at $50.00 per share ($9,000.00) and 62 of its common shares at $500.00 per share ($31,000.00).

On June 28, 1943, the petitioner purchased from Abbott Merchandising and Finance Company (a Massachusetts corporation hereinafter called "Abbott") certain merchan-

dise consisting of drapery and upholstery fabrics for 200 shares of petitioner's common stock which had a stated value of $100,000.00 as above set forth. Such purchase was made pursuant to a resolution of the petitioner's Board of Directors which set forth the judgment of the Board that the value of such merchandise was $100,000.00 and which authorized the issuance of said 200 shares therefor. (Rec. 35a and 36a). Accordingly, the petitioner carried the cost of said merchandise on its books at $100,000.00 and the invested capital represented by said 200 shares at a like figure; and the petitioner's tax return for the period April 9 to December 31, 1943 reflected that amount of cost and invested capital (R. 109a).

By a notice of deficiency mailed to the petitioner on March 10, 1949, the Commissioner reduced the petitioner's said acquisition cost of said merchandise and also the petitioner's equity invested capital from $100,000.00 to $30,000.00. The basis of that reduction was that Abbott, the petitioner's vendor, had purchased said merchandise, on May 7, 1943, from Mount Hope Finishing Company (a Massachusetts corporation hereinafter called "Mount Hope") for $30,000.00. This amount, the cost to Abbott, was determined by the Commissioner to be the market value of said merchandise on June 28, 1943, the date when Abbott sold it to the petitioner for the 200 shares of petitioner's common stock.

At the trial before The Tax Court, the petitioner introduced the following uncontradicted evidence as to the market value of said merchandise on June 28, 1943:

(a) Testimony of the manager (Frank J. Mann) of the department of Mount Hope which had purchased, styled and converted said merchandise that the fair market value

thereof on June 28, 1943 was at least $100,000.00 (R. 53a, 67a and 69a).

(b) An itemized inventory of said merchandise (hereinafter called "said inventory") prepared by said department of Mount Hope on March 31, 1943. Said inventory shows that said merchandise consisted of (a) nineteen (19) items of unfinished goods (*i.e.*, grey goods and goods in process), which were described by kind, width, construction and weight and were inventoried at a value of $67,128.50, and (b) 56 items of finished goods (*i.e.*, goods ready for sale) which were described merely by style number and were inventoried at a value of $33,645.00. The inventory showed the aggregate value of all the items at $100,773.50 (R. 93a to 96a).

(c) Copies of the Daily News Record, the accredited journal of the textile industry, which reports for each day the prevailing prices per yard for textile fabrics of the various kinds, widths, constructions and weights (R. 85a). According to the quotations of prices prevailing on June 28, 1943 (R. 107a), the nineteen items of unfinished goods alone (*i.e.*, grey goods and goods in process) aggregated in value in excess of the amount ($67,128.50) at which they were valued in said inventory (R. 93a and 94a).

(d) Testimony by a textile manufacturer's selling agent (Tappen, R. 76a and 77a) and also by a textile manufacturer (Van Buskirk, R. 80a to 84a), both of long experience in the textile industry, as to the high standing of the Daily News Record and as to the correctness of the price quotations published therein.

(e) Invoices from various well known mills showing purchases made by the petitioner in April, May and June

1943 of fabrics of the same kinds at the prices quoted in the Daily News Record and somewhat higher than the values assigned to such goods in said inventory (R. 106a and 93a).

(f) Invoices of sales of some of the finished goods, made by the petitioner to stores and to jobbers promptly after June 28, 1943 at very profitable prices over the prices stated in said inventory and over the $100,000.00 cost carried by the petitioner (R. 108a).

None of that evidence strongly supporting the valuation made by the Board of Directors was contradicted. No question was raised as to the good faith of the Board of Directors in reaching their judgment as to the value of $100,000.00.

The only witness for the respondent was a revenue agent (Tyne) who testified, over the objection and exception of the petitioner, to a conversation in June 1948 between him and a stockholder of the petitioner. While overruling the petitioner's objection, to this conversation, the trial judge, said: "It would seem to me it wasn't binding on the corporation" (R. 87a and 88a).

The Government's only witness did not even attempt to qualify as to knowledge of or experience with the market value of such merchandise; nor did he testify, of his own knowledge, as to the market value thereof on June 28, 1943.

Contrary to the valuation made by the Board of Directors and to the uncontradicted evidence of market prices prevailing on June 28, 1943, the Court of Appeals affirmed The Tax Court in holding that the value of said merchandise on that date was the cost thereof to Abbott on May 7, 1943, *i.e.*, $30,000.00.

Statutes Involved

In the courts below, the petitioner relied upon the effect to be given, under the Tenth Amendment to the Constitution of the United States, to the provisions of two sections of the New York Stock Corporation Law, in force in June 1943 when the judgment of the petitioner's Board of Directors as to value was made, namely:

Section 69 provided, as follows:

> "No corporation shall issue either shares of stock or bonds, except for money, labor done or property actually received for the use and lawful purposes of such corporation * * * Any corporation may purchase any property authorized by its certificate of incorporation, or necessary for the use and lawful purposes of such corporation, and *may issue stock to the amount of the value thereof in payment therefor*, and the stock so issued shall be full paid stock and not liable to any further call, neither shall the holder thereof be liable for any further payment under any of the provisions of this chapter; *and in the absence of fraud in the transaction the judgment of the directors as to the value of the property purchased shall be conclusive*; * * *" (Emphasis supplied.)

Section 12, which deals with "Shares without par value," provided that such shares may be issued

> "* * * (b) for such consideration as shall be the fair market value of such shares, and, in the absence of fraud in the transaction, the judgment of the board of directors as to such value shall be conclusive; or (c) in the absence of fraud in the transaction, for such consideration as, from time to time, may be fixed by the board of directors * * *"

"Internal Revenue Code.

Section 113(a) Basis (unadjusted) of Property. The basis of property shall be the cost of such property; * * *

Section 718. Equity Invested Capital. * * *

(a)(2) Property Paid In. * * * Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange."

Questions Presented

1. Whether the provisions of Sections 69 and 12 of the New York Stock Corporation Law were within the area of powers reserved to the State of New York under the Tenth Amendment to the Constitution of the United States.

2. Whether the good-faith judgment of value made by the petitioner's Board of Directors was entitled to be accorded the legal effect provided in said Sections 69 and 12.

3. Whether the legal effect required by those sections of the New York Stock Corporation Law to be accorded to the good-faith judgment of value made by the petitioner's Board of Directors, and the strong support of such judgment by the uncontradicted evidence as to the market prices prevailing on June 28, 1943, could be disregarded.

4. Whether the cost to the petitioner's vendor on May 7, 1943 justified the disregard of the legal effect provided by Sections 69 and 12 of the New York Stock Corporation Law to be accorded to the good-faith judgment of value made by the petitioner's Board of Directors and the uncontradicted evidence of the market prices prevailing on June 28, 1943.

Reasons for Granting the Writ

1. The decision below conflicts with the Tenth Amendment to the Constitution of the United States in failing to accord to the judgment of the petitioner's Board of Directors the legal effect provided by Sections 69 and 12 of the New York Stock Corporation Law.

2. The decision below is in conflict with decisions of other Courts of Appeals of the United States.

3. The decision below is the only tax case in which the good-faith determination made by a board of directors of a stock corporation as to the value of property purchased by such corporation for shares of its capital stock was not upheld as against the Commissioner of Internal Revenue.

4. The questions presented by the petitioner are of public importance in tax administration.

5. The questions presented by the petitioner are of public importance in the administration of stock corporations generally.

Respectfully submitted,

MARK M. HORBLIT,
Attorney for Petitioner.

Supreme Court of the United States

MAY TERM, 1953

No. .....

COLONIAL FABRICS, INC.,

Petitioner,

—v.—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION

A. The decision of the Court of Appeals is erroneous in failing to accord to the Board of Directors' judgment as to value the legal effect to which it is entitled under the provisions of Sections 69 and 12 of the New York Stock Corporation Law and under the Tenth Amendment to the Constitution of the United States.

The petitioner contended below that, there being no claim of lack of good faith on the part of the Board of Directors, their determination that the value of the merchandise was $100,000.00 was entitled, under the Tenth Amendment to the Constitution of the United States, to be accorded the legal effect prescribed by Sections 69 and 12 of the New York Stock Corporation Law.

The language of Section 69 is clear and unambiguous that:

> "No corporation shall issue either shares of stock or bonds, except for money, labor done or property actually received * * *"

This express statutory prohibition requires that where shares of stock are issued for property, the value of the property must equal the par value of the shares issued therefor (Sec. 69), or in the case of shares without par value, the stated value (Sec. 12) of the shares issued for such property. This was expressly decided by the New York Court of Appeals in *Gamble* v. *Queens County Water Co.*, 123 N. Y. 91, a case arising before the advent of the era of shares without par value. In that case, the Court says at page 106:

> "We think that under the Manufacturing Act, the company cannot issue its stock as full paid at anything less than its par value."

This Court has decided that state statutes, like Sections 69 and 12, regulating the creation and administration of the affairs of stock corporations come within the powers reserved to the states under the Tenth Amendment to the Constitution of the United States; and has held such state statutes valid and binding in connection with the administration of a federal statute.

In *Hopkins Federal Savings & Loan Association* v. *Cleary*, 296 U. S. 315; 56 S. Ct. 235, the controversy concerned the operation of the Federal Home Owners' Loan Act with respect to provisions of Wisconsin statutes regulating Wisconsin corporations.

In an unanimous decision, this Court, speaking by Mr. Justice Cardozo, invoked the Tenth Amendment to the Constitution of the United States in upholding the Wisconsin statute and said at page 241:

> "How they [corporations organized under state laws] shall be formed, how maintained and supervised, and how and when dissolved are matters of govern-

mental policy, which it would be an intrusion for another government (the Federal government) to regulate by statute or decision."

In *Chicago Title & Trust Co.* v. *Forty-One Thirty-Six Wilcox Bldg. Corp.*, 302 U. S. 120; 58 S. Ct. 125, the issue was whether statutory provisions of the State of Illinois as to the existence of an Illinois corporation were enforceable in proceedings under the Federal Bankruptcy Act. In reversing the Court of Appeals, this Court applied to a stock corporation (at p. 128) "the principle recently announced in" the *Hopkins Federal Savings Association* case which "dealt with an intrusion by the federal government on the powers of the state over state building and loan associations"; and went on to say at page 128:

> "The circumstances under which the power [of a corporation organized under State law] shall be exercised and the extent to which it shall be carried are matters of state policy, to be decided by the State Legislature."

It is thus settled by the decisions of this Court that statutes of a state which regulate the administration of the affairs of corporations organized under the laws of that state are within the powers reserved to the state by the Tenth Amendment to the Constitution of the United States.

There can be no question that Sections 69 and 12 of the New York Stock Corporation Law, which regulate the issuance by a New York corporation of its shares of stock and bonds for property, come within the area of powers reserved to the states. Those statutes place upon the directors the responsibility of seeing to it that the corporation receives full value in property where shares are issued for property. The petitioner's Board of Directors

having acted in unchallenged good faith in adjudging the fair value of the merchandise at $100,000.00, it is respectfully submitted that it is "an intrusion" (as this Court has called it) for a department of the Federal government to compel the petitioner, several years later, to reduce that valuation.

The confusion and chaos that would result if such an "intrusion" into the administration and financial setup of stock corporations were permitted, is readily apparent. Upon shares of stock being issued for property at the valuation made by the Board of Directors, the financial statements thereafter rendered by the corporation to banks and to others from whom credit is sought naturally reflect such value of the property and the corresponding increase in capital. The corporate books, the tax returns to the various states where the corporation does business, and the financial reports to stockholders, to business organizations, and to the various governmental departments (city, state and federal) to whom such reports are rendered, naturally reflect that value of the property. All such activities are carried on by a New York stock corporation with the full blessing of sections 69 and 12, the good faith of the directors being unquestioned. This was the situation in the instant case for a period of nearly six years, *i.e.*, from June 28, 1943, when the merchandise was purchased, to March 10, 1949, when the commissioner by his notice of deficiency sought to compel the reduction in the directors' valuation. It is plain that the corporation's books, the financial statements and reports and the various tax returns signed and filed for the petitioner by its officers and directors during the interim would all be affected if the proposed reduction in valuation as of June 28, 1943 is permitted to stand. It is respectfully submitted that the petitioner and its officers and directors should not be placed in such a confusing and embarrassing situation, the directors' good faith being un-

challenged and the petitioner having acted fully within its rights under sections 69 and 12.

The application to the Commissioner of Internal Revenue of those state statutes respecting the regulation of corporations is in line with several other instances where the Commissioner has been held by this Court to be bound by State law. The following are but a few of many such decisions by this Court.

Uterhart v. *U. S.*, 240 U. S. 598, 36 S. Ct. 417;

(Whether a legatee of a New York testator took a contingent interest.)

Crooks, Collector v. *Harrelson*, 282 U. S. 55; 51 S. Ct. 49;

(Whether real estate of a Missouri decedent "is subject to the payment of the charges against his estate and the expenses of administration" under the language of Sec. 402 of the Revenue Act of 1918, so as to be includible in the decedent's gross estate.)

Helvering v. *Fuller*, 310 U. S. 609, 60 S. Ct. 784;

(Whether a property settlement, comprised of shares of stock, made by a husband to a trustee for the benefit of the wife in connection with a divorce, discharged the marital obligation of the husband to support the wife, so that dividends received on such shares were not taxable by the Commissioner to the husband.)

Freuler v. *Helvering*, 291 U. S. 35, 54 S. Ct. 308.

(Amount distributable to a beneficiary under a testamentary trust, for the purpose of assessment of a Federal tax against the beneficiary.)

B. The decision below is in conflict with decisions of United States Courts of Appeals in other circuits.

The decision below is the only one where a United States Court of Appeals failed to uphold, as against the Commissioner, a valuation made in good faith by the Board of Directors of a corporation, of property purchased by the corporation for shares of its stock. The decision below is in conflict with the decisions of other circuits.

> *Planters' Operating Co.* v. *Commissioner*, 55 F. 2d 583 (C. C. A. 8th);
> *Sioux City Stockyards Co.* v. *Commissioner*, 59 F. 2d 944 (C. C. A. 8th);
> *Rookwood Pottery Co.* v. *Commissioner*, 45 F. 2d 43 (C. C. A. 6th).

In *Planters' Operating Co.* v. *Commissioner, ubi supra,* the Circuit Court of Appeals (Eighth Circuit) reversed the Board of Tax Appeals which had sustained the Commissioner in his disregard of the valuation of a lease which had been purchased by the taxpayer (a Missouri corporation) for $200,000.00 in par value of its stock. The Court says at page 586:

> "It is to be noted that the purchase of the lease by the petitioner was approved both by the board of directors and by the stockholders of petitioner. It should be further noted that section 8, article 12, of the Constitution of Missouri and section 9740 of Revised Statutes of Missouri, 1919, both plainly contemplate that stock of a corporation should be issued only for something having value, as cash, labor, or property. Under those provisions, it has been held that, where a corporation issues stock in payment for

property, the property must be the fair equivalent in value of the par value of the stock issued for it (cases cited). The presumption is that the petitioner corporation acted lawfully instead of unlawfully in the issuance of its stock * * *"

It is to be noted that in the *Planters'* case, the Missouri statute involved was like Section 69 of the New York Stock Corporation Law in requiring, as stated in the opinion in that case, that "where a corporation issues stock in payment for property, the property must be the fair equivalent in value" of the stock issued for it. Although the Missouri statute did not make the directors' good-faith judgment of value "conclusive," as Sections 69 and 12 of the New York statutes do, the Court of Appeals in the *Planters'* case nevertheless reversed the Board of Tax Appeals and sustained the $200,000.00 valuation made by the board of directors in that case. The presumption "that the petitioner corporation acted lawfully instead of unlawfully in the issuance of its stock" led the Court of Appeals to reverse in the *Planters'* case. Why was not the petitioner in the instant case entitled to like treatment by the court below, even aside from the provision of the New York statutes as to the conclusiveness of the directors' valuation in the absence of fraud?

Again, in *Sioux City Stockyards Co.* v. *Commissioner, ubi supra,* the taxpayer, an Iowa corporation, issued shares of stock for property, pursuant to a resolution of its Board of Directors. The articles of incorporation provided that shares of stock "shall be fully paid for in cash or its equivalent at or before the time the same is issued." The Commissioner assessed a deficiency tax on the basis that the fair value of the property was less than the par value of the stock issued for it. In that case, the Court of Appeals

reversed the Board of Tax Appeals which sustained the Commissioner, even in the absence of statutory provisions like those of New York making the good-faith judgment of the directors "conclusive".

(3) In *Rockwood Pottery Co.* v. *Commissioner of Internal Revenue, ubi supra,* the United States Circuit Court of Appeals for the Sixth Circuit reversed a judgment of the Board of Tax Appeals which had sustained the Commissioner of Internal Revenue with respect to his claim that the taxpayer corporation had accepted, in payment for its stock, property which was worth less than the par value thereof. In that case, the Circuit Court of Appeals says at page 45:

> "The law of Ohio, doubtless familiar to the organizers and their counsel, permitted property to be used in payment for stock only at the actual cash value of the property, and these organizers and their advisors cannot now be presumed to have intended a violation of this law. The contemporaneous sale of the remainder of the capital stock, for cash, at par, confirmed this valuation."

Likewise in the instant case, shares of common stock had been issued by the petitioner shortly prior to June 28, 1943 at $500.00 per share, the stated value which had been fixed for such shares by the resolution adopted on April 9, 1943 in accordance with the provisions of Section 12.

(4) The decision herein sought to be reviewed is also contrary to the decision in *Estate Planning Corporation* v. *Commissioner of Internal Revenue,* 101 Fed. 2nd 15 (C. C. A. 2nd). In that case, a newly organized New York corporation issued $600,000.00 of its bonds in payment for the good-will of a business, pursuant to a valuation made by

its Board of Directors. The Commissioner claimed that the good-will was of no value, and he therefore refused to recognize the bonds as obligations of the corporation. The Board of Tax Appeals sustained the Commissioner; but the Court of Appeals reversed, and said at page 16:

> "Section 69 of the Stock Corporation Law of New York, Consol. Laws, c. 59 (L. 1890, c. 564, as amended) provides that 'No corporation shall issue either shares of stock or bonds, except for money, labor done, or property actually received for the use and lawful purposes of such corporation * * * and in the absence of fraud in the transaction the judgment of the directors as to the value of the property purchased shall be conclusive; * * * '. Therefore, *the directors of the petitioner, in the absence of fraud, were to determine the valuation of the property purchased under the Stock Corporation Law of New York. The legislature of the State had the authority and responsibility of lodging such determination in the directors.*" (Emphasis supplied.)

It is to be noted that the prohibition of Section 69 applies, by its express terms, to bonds as well as to shares of stock. It was avowedly and expressly on the basis of the provisions of Section 69 that the Court of Appeals reversed in the *Estate Planning* case, and held that the Commissioner could not reduce the valuation made by the directors because "The legislature of the state had the authority and responsibility of lodging such determination in the directors."

It is confidently submitted that there is not a case in the books where the Courts of Appeals have failed to uphold, as against the Commissioner of Internal Revenue, the judgment of value, made in good faith by a Board of Directors of a stock corporation, of property purchased with

shares of such corporation and where the judgment of the directors is supported by the uncontradicted evidence of actual market value on the date of purchase.

CONCLUSION

For the reasons stated, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

MARK M. HORBLIT,
Attorney for Petitioner.

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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 799

COLONIAL FABRICS, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 97-111) is not reported. The opinion of the Court of Appeals (R. 139-146) is reported in 202 F. 2d 105.

JURISDICTION

The judgment of the Court of Appeals was entered on February 16, 1953. (R. 146-147.) The petition for a writ of certiorari was filed on May 13, 1953. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the courts below erred in holding that the valuation by taxpayer's directors of property received by the taxpayer for its stock did not conclusively establish the value of that property for federal excess profits tax and declared value excess profits tax purposes.

STATUTES AND CONSTITUTIONAL PROVISION INVOLVED

The pertinent statutes and the Tenth Amendment to the United States Constitution are set out in the Appendix, *infra,* pp. 11-14.

STATEMENT

The sole issue presented is a difference as to valuation of property received by taxpayer in payment for 200 shares of its common no-par value stock. The value set by taxpayer and supported by it throughout is $100,000; this figure was reduced by the Commissioner to $30,000, and the Tax Court found as a fact that $30,000 was the fair market value of the property transferred on the date of exchange. (R. 109, 139-140.) The Court of Appeals concluded that this result was not clearly erroneous and that the Tax Court could legally reach it on all the evidence. (R. 143-145.) The tax consequence of this decrease in valuation of the property received for taxpayer's stock was a corresponding reduction in taxpayer's "equity invested capital", as defined by Section 718 (a)(2) of the Internal Revenue Code (Appendix, *infra,* p. 11). Because of this and certain other adjustments not contested, the Tax Court determined deficiencies

in 1943 of $2,857.43 in taxpayer's declared value excess profits tax and $63,096.50 in its excess profits tax (R. 130, 139-140), which the court below affirmed (R. 146-147).

The Tax Court and the Court of Appeals found the facts, part of which were stipulated (R. 30-36), as follows:

Taxpayer was incorporated under the laws of New York on April 9, 1943; the tax period here involved is from that date until the end of 1943. Taxpayer's authorized capital stock was 1,000 no-par value shares, of which 500 were preferred and 500 common. Its stock was not dealt in on any market, and had been issued for property as well as cash. (R. 100-102, 105, 140.)

At the first meeting of taxpayer's board of directors on April 9, 1943, a resolution was adopted that the shares of preferred stock be issued for cash at $50 per share and that the shares of common stock be issued for cash or property at $500 a share. (R. 100.)

The property in question here, received by taxpayer in payment for 200 shares of its common stock, consisted of drapery materials which had been owned by Mount Hope Finishing Company and its Dighton-Colonial Department, for which another corporation, Colonial Drapery & Curtain Corporation, acted as selling agent. Mount Hope had been engaged in the same business for which taxpayer was organized, namely, buying and converting drapery material and upholstery fabrics, and selling these to retailers, jobbers, and manufac-

turers of drapery and furniture. Mount Hope had determined to close its Dighton-Colonial Department and thus to dispense with the services of the Curtain Corporation. (R. 97-98, 140.)

On April 1, 1943, an inventory was prepared by the staff of the Curtain Corporation under the direction of Frank J. Mann, its secretary-treasurer and general manager. This showed three classes of merchandise, *viz.*, eight items of "grey goods" (fabrics in an unfinished condition) at a total cost of $13,946.43; eleven items of "goods in process" at a total of $53,182.07; and fifty-seven items of "finished goods" at $33,645—or an over-all total of $100,773.50. (R. 98-100, 140.) This was in large part a broken lot inventory purposely reduced by Mount Hope, with some discontinued styles (it being a practice in the trade to introduce styles every week). (R. 97-98, 110, 140.)

On May 7, 1943, Mount Hope sold the goods to Abbott Merchandising and Finance Company, for $30,000 cash. (R. 98, 140.)

Meanwhile, Mann became incorporator, stockholder, director, and vice-president of the new company—the taxpayer—which employed his Curtain Corporation as its selling agent. (R. 140.) On May 28, 1943, Mann wrote Abbott a letter, in which he described himself as the Curtain Corporation's treasurer, making an offer for the goods in exchange for 150 shares of taxpayer's common stock. (R. 102-105.) Among other details the letter stated that "this close-out inventory" would have "quite substantially greater" value to taxpayer

than to other converters or dealers—since no one else was in as good a position "to handle and merchandise this inventory to the best advantage." (R. 141.) The letter continued that since he (Mann) had been "largely instrumental in the selection, styling and merchandising of the inventory" in the first place as treasurer of the Curtain Corporation, and since he had been "making efforts to have a corporation organized to take the place which Mount Hope recently held in relation to" Curtain Corporation (R. 141)—

> The new corporation could handle the inventory with peculiar advantage by reason of its opportunities to match and fill in shades, patterns and styles for retailers and jobbers with whom the Dighton-Colonial Department dealt and whom we know well * * *.

Mann counseled haste in acceptance of this offer for the shares of common stock, advising that the Dighton-Colonial customers should be approached promptly (R. 141)—

> if the great though intangible value of the good-will, established with those customers at immense expense and cost over a period of nearly half a century, is to be preserved. Delay will afford competitors opportunities which may, as you can readily imagine, result in loss of this valuable good-will with those customers.

Stating that the "new corporation is not in a position to purchase the inventory from you for cash" (R. 141), Mann expressed the opinion that

if Abbott would transfer the inventory in exchange for taxpayer's common stock, the (R. 103)—

> arrangement would be advantageous to you, for I am confident that the new corporation [petitioner] should prosper and that consequently you will, eventually, be able to realize for such shares of stock a much larger amount than you can possibly realize out of this inventory in any other way.

The letter, finally, offered for the merchandise a total of 150 shares at $500 per share, or a face value of $75,000. (R. 142.)

The deal when finally completed on June 28, 1943, called for a payment of 200 shares of taxpayer's common stock at a face value of $100,000. (R. 105, 142.) In a resolution of taxpayer's directors, adopted on June 14, 1943, this purchase for 200 shares of common stock was approved, the directors stating in their resolution that "said merchandise is worth one hundred thousand ($100,000.00) dollars," and that Mann, taxpayer's vice-president, was familiar with the merchandise, and with customers carrying such goods in their inventories (R. 35-36, 142).

Emphasizing the fact that the Abbott Company, from which taxpayer received the property in question for its stock, had purchased this property only a few weeks earlier for $30,000, the Tax Court found (R. 110) that "the record fails to supply convincing evidence that the sale of the identical property for cash a few weeks prior to the trans-

fer to [taxpayer] is not the best evidence of its value on the date in issue." Reviewing this and other factors (R. 110-111), the court approved the Commissioner's determination that the fair market value of the property when received by the taxpayer was $30,000.

ARGUMENT

The decision of the court below is correct and presents no question warranting further review by this Court. The court below properly concluded that the Tax Court had meticulously found all the facts bearing upon the issue (R. 142) and that on all the evidence the result which the Tax Court had reached was not clearly erroneous (Rule 52(a), Federal Rules of Civil Procedure); that the Tax Court was warranted in accepting as convincing the factor of objective market value, namely, the $30,000 cash sale price to Abbott of the identical property a few weeks prior to the transfer to taxpayer (R. 110, 143-145) and, on the other hand, that the $100,000 value placed on taxpayer's stock was built upon future hope, and was not even represented to Abbott as present worth (R. 144). The Tax Court concluded that taxpayer had afforded no satisfactory explanation why Mount Hope should have been willing to sell the merchandise for less than its fair market value. (R. 110.) As the court below held, taxpayer's case amounted simply to an argument that the federal revenue authorities were required to accept a top figure for individual items in the market and to reject the actual sale price brought by the goods as a whole in a prac-

tically contemporaneous cash transaction. (R. 145.)

Here, abandoning most of its arguments below, taxpayer makes substantially a single contention (Pet. 7-8; Br. 9-13)—that the judgment of its directors as to the value of the property received for the stock is, by virtue of the New York Stock Corporation Law (58 McKinney's Consolidated Laws of New York Annotated (1951)), Sections 12 and 69 (Appendix, *infra*, pp. 12-14), controlling here, and that failure to accept the directors' valuation as conclusive for federal tax purposes infringes the Tenth Amendment to the Constitution.

The argument is palpably without merit.* There is no basis for the view that the States, even if they sought to, could make conclusive rules foreclosing factual inquiry into the value of property for federal tax assessment purposes. Moreover, as the court below held (R. 144-145), the state statute the taxpayer invokes was directed to the problems of corporate organization, definition of stockholders' liabilities, and assurance that corporations receive valuable assets in exchange for their obligations. *Gamble* v. *Queens County Water Co.*, 123 N. Y. 91; *First Nat. Bank* v. *Cornell*, 8 App. Div. 427 (4th Dept.). Nothing in this scheme requires or suggests that the directors' valuation of property received for stock should be binding for federal tax

* It should be noted that, in its argument below, the taxpayer made only a passing, rhetorical reference to the Tenth Amendment (Ct. of App. Br., p. 40), and the constitutional question sought to be raised here was neither directly presented to nor passed upon by either of the lower courts.

purposes; the valuation was properly treated as some evidence of value, but was, equally properly, regarded by the fact finder as overcome by other facts in evidence. (R. 111, 145.)

Contrary to taxpayer's contention (Br. 14-18) there is no conflict of decisions requiring resolution by this Court. *Sioux City Stock Yards Co.* v. *Commissioner,* 59 F. 2d 944 (C. A. 8), *Planters' Operating Co.* v. *Commissioner,* 55 F. 2d 583 (C. A. 8), and *Rookwood Pottery Co.* v. *Commissioner,* 45 F. 2d 43 (C. A. 6), merely hold, as did both tribunals below, that directors' valuations under similar state statutes constitute some evidence of value, to be weighed in the circumstances of each case with the other evidence. They do not hold that directors' valuations govern the Commissioner in assessing federal taxes.

Estate Planning Corp. v. *Commissioner,* 101 F. 2d 15, decided by the court below, was properly described in its opinion here as dealing with another issue, namely, the validity of bonds issued by a corporation for property (R. 145), and was not concerned with the valuation of the property received for the bonds.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JUNE, 1953.

APPENDIX

Internal Revenue Code:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 113.)

SEC. 718 [As added by Sec. 201, Second Revenue Act of 1940, c. 757, 54 Stat. 974.] EQUITY INVESTED CAPITAL.

(a) *Definition.*—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

* * * * *

(2) [as amended by Sec. 218 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Property Paid In.* — Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined under the law applicable to the year of disposition,

but without regard to the value of the property as of March 1, 1913. If the property was disposed of before March 1, 1913, its basis shall be considered to be its fair market value at the time paid in. If the unadjusted basis of the property is a substituted basis, such basis shall be adjusted, with respect to the period before the property was paid in, by an amount equal to the adjustments proper under section 115(l) for determining earnings and profits; * * *.

* * * * *

(26 U.S.C. 1946 ed., Sec. 718.)

58 McKinney's Consolidated Laws of New York Annotated (1951) (Stock Corporation Law):

Article 3—General Provisions

§ 12. *Shares without par value*

* * * * *

* * * such corporation may issue and may sell its authorized shares without par value from time to time, (a) for such consideration as may be prescribed in such certificate of incorporation; or (b) for such consideration as shall be the fair market value of such shares, and, in the absence of fraud in the transaction, the judgment of the board of directors as to such value shall be conclusive; or (c) in the absence of fraud in the transaction, for such consideration as, from time to time, may be fixed by the board of directors pursuant to authority conferred in such certificate of in-

corporation; or (d) for such consideration as shall be consented to or approved by the holders of a majority of the shares entitled to vote at a meeting called in the manner prescribed by the by-laws, provided the call for such meeting shall contain notice of such purpose. Any and all shares issued as permitted by this section shall be deemed fully paid and non-assessable and the holder of such shares shall not be liable to the corporation or to its creditors in respect thereto.

* * * * *

Article 7—Stock and Stockholders

§ 69. *Consideration for issue of stock and bonds*

No corporation shall issue either shares of stock or bonds, except for money, labor done or property actually received for the use and lawful purposes of such corporation. No shares of stock having par value shall be issued for money in an amount less than the par value of such shares. Any corporation may purchase any property authorized by its certificate of incorporation, or necessary for the use and lawful purposes of such corporation, and may issue stock to the amount of the value thereof in payment therefor, and the stock so issued shall be full paid stock and not liable to any further call, neither shall the holder thereof be liable for any further payment under any of the provisions of this chapter; and in the absence of fraud in the transaction the judgment of the directors as to the value of the property

purchased shall be conclusive; and in all statements and reports of the corporation by law required to be published or filed, this stock shall not be stated or reported as being issued for cash paid to the corporation, but shall be reported as issued for property purchased. * * *

* * * * *

Constitution of the United States of America:

AMENDMENT X—RESERVED POWERS TO STATES

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

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